

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MALETSWAI LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Maletswai Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the applicable financial reporting framework and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2010 (Act No. 1 as amended), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

7. Tools and equipment, and office equipment with a previous carrying value of R4 494 299 were adjusted to a carrying value of R Nil as disclosed in notes 10 and 33.01 to the financial statements. The carrying value was written down as part of the process that the municipality has implemented in making use of the transitional provisions of Directive 4 as issued by the Accounting Standards Board, which provides for a transitional period during which the municipality is not required to measure property, plant and equipment for reporting periods beginning on or after a date within three years following the initial adoption of the Standard of GRAP on property, plant and equipment.
8. A detailed list of the assets that comprise these adjustments could not be provided for audit purposes. As a result, I was unable to determine whether the assets that were written down to R Nil are still included in the fixed asset register of the municipality, and therefore I was not able to confirm the existence of these assets.

Corresponding figures

9. The auditor's report for the year ended 30 June 2010 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the audit. The matters which gave rise to the limitation, as described below, remain unresolved in the current year.
10. The municipality has not corrected the following reported misstatements:
 - Revenue from non-exchange transactions is overstated by an amount of R290 780 as a result of revenue being recognised at incorrect rates disclosed in note 20 to the financial statements.
 - Revenue from exchange transactions is overstated by an amount of R192 381 as a result of revenue being recognised at incorrect tariffs disclosed in note 22 to the financial statements.
 - Revenue from exchange transactions is understated by an amount of R63 843 as a result of interest not being levied on overdue accounts.
11. The municipality could not provide sufficient appropriate audit evidence regarding:
 - Revenue from traffic fines of R223 957 included in the statement of financial performance
 - Revenue from rental of facilities and equipment of R1 500 000 included in the statement of financial performance
 - Revenue from electricity and reconnection fees of R735 658 disclosed in notes 24 and 33 to the financial statements
 - Revenue from additional refuse pickups of R4 200 000 disclosed in note 22 to the financial statements
 - Other revenue of R455 260 disclosed in note 24 to the financial statements.

12. I was unable to confirm or verify these amounts by alternative means and, as a result, I could not confirm the occurrence, accuracy, cutoff, completeness and classification of the above amounts included in the corresponding figures.

Qualified opinion

13. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Maletswai Local Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with the applicable financial reporting framework and the requirements of the MFMA.

Emphasis of matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Financial reporting framework

15. As disclosed in note 1 to the financial statements, the municipality has adopted the transitional provisions in terms of Directive 4 "Transitional Provisions for Medium and Low Capacity Municipalities" issued by the Accounting Standards Board.

Restatement of corresponding figures

16. As disclosed in notes 33 and 34 to the financial statements, the corresponding amounts included in the financial statements for the financial year ended 30 June 2011 have been restated for the purposes of corrections of errors in the prior year.

Financial sustainability

17. The municipality is influenced by various financial, operating and other indicators which affect its financial sustainability. These are fully disclosed in note 51 to the financial statements.

Unauthorised and irregular expenditure

18. As disclosed in note 40.1 to the financial statements, the municipality incurred unauthorised expenditure to the amount of R14 077 459 due to funds having been expended for purposes other than for purposes of conditional grants for which they were intended.
19. As disclosed in note 40.3 to the financial statements, the municipality incurred irregular expenditure to the amount of R3 236 052 as a result of non-compliance with the requirements of the Construction Industry Development Board (CIDB) in awarding construction tenders.

Material losses

20. As disclosed in note 40.4 to the financial statements, the municipality suffered significant electricity distribution losses of R2 615 666 (15%) (2010: R898 292 (6%)) during the year under review.
21. As disclosed in note 40.4 to the financial statements, the municipality suffered significant water distribution losses of R467 198 (57%) (2010: R Nil (0%)) during the year under review.

Additional matter

22. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

23. The supplementary information set out on pages XX to XX do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly, I do not express an opinion on thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

24. In accordance with the PAA and in terms of *General Notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives**Usefulness of information**

25. The reported performance information was deficient in respect of the following criteria:

26. Consistency: The reported objectives, indicators and targets are not consistent with the approved integrated development plan.

27. Reported performance against predetermined objectives is not consistent with the approved integrated development plan (50% of the planned objectives in the approved integrated development plan were not included in the reported performance.)

Compliance with laws and regulations**Annual financial statements, performance and annual report**

28. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors were corrected, resulting in the financial statements receiving a qualified audit opinion.

29. The accounting officer did not, within seven days of its adoption, make public the council's oversight report on the 2009-10 annual report, as required by section 129(3) of the MFMA.

Internal audit

30. The municipality did not have an internal audit unit in place as required by section 165(1) of the MFMA for two months of the year under review.

Procurement and contract management

31. Instances of non-compliance with the requirements of SCM regulation 21(b) (26% of awards tested) were found in which the preference points system to be used in the adjudication of bids was not stated either in the notice inviting tenders or in the tender documentation.

32. All bid evaluation committees did not consist of at least one SCM practitioner of the municipality as per the requirements of SCM regulation 28(2) for all the bids evaluated.

33. Not all suppliers to whom awards were made submitted a declaration on their employment by the state or their relationship to a person employed by the state as per the requirements of Municipal SCM regulation 13(c).

34. For 80% of the construction contracts awarded, there was insufficient evidence that the contractors were registered and qualified for the contract in accordance with the Construction Industry Development Board (CIDB) Regulations¹⁷ and 28(A) and section 18 of the Construction Industry Development Board Act, 2000 (Act No. 38 of 2000).

Expenditure management

35. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

36. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

INTERNAL CONTROL

37. In accordance with the PAA and in terms of *General Notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

38. The leadership does not exercise its oversight over the municipality's compliance with laws and regulations. It has not held management accountable for reporting on its monitoring of compliance. The leadership has also not exercised oversight in terms of the funding of operations of the municipality. This has resulted in items of non-compliance being reported and casting doubt over the financial sustainability of the municipality. The leadership does not take a systematic and detailed approach to holding management accountable for compliance and for financial and performance management, and the development of a proactive approach and an in-depth understanding of the meaning and requirements of the oversight processes is required.

Financial and performance management

39. Management has not yet completed the implementation of plans to address previous audit findings and previous deficiencies in key controls, which has resulted in uncorrected misstatements and prior period limitations having a continuing effect on the fair presentation of the current year's financial statements. The audit area of property, infrastructure, plant and equipment is still not supported by a fully compliant, complete asset register, and the audit trail between asset adjustments and the asset register is weak. Management did not review the annual report of performance against predetermined objectives for completeness and accuracy before it was submitted for audit purposes. The correction of material misstatements and the reliance on consultants for the preparation of the financial statements and supporting documentation submitted for auditing have contributed substantially to the improvement in the audit outcome. There is doubt about the sustainability of this improvement without the continued appointment of consultants, unless a transfer of skills occurs. Management has not managed performance using sound business practices in the management of expenditure, resulting in unauthorised expenditure where unspent conditional grants are utilised to fund operational and service delivery activities.

Governance

40. Those charged with governance did not conduct a review of the report of performance against predetermined objectives.



Auditor-General

East London

30 November 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence